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Flexible Benefit Plans for Federal Employees

Statement of
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Subcommittee on Employment and Housing
Committee on Government Operations
House of Representatives

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ISSUES RELATED TO FLEXIBLE
BENEFIT PLAN FOR FEDERAL EMPLOYEES

SUMMARY OF STATEMENT BY
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In response to a request from the Honorable Tom Lantos, Chairman of the Subcommittee on Employment and Housing, GAO agreed to discuss a potential design of a flexible benefit plan for federal employees. In addressing this matter, three questions need to be considered: (1) whether now is the time to adopt such a plan, (2) what kind of plan would be best, and (3) what would be the resulting cost to the government.

In summary:

1) The government's compensation policy has been traditionally based on the principle of comparability which holds that the government should be neither ahead nor behind the private sector in the compensation it provides its employees. GAO found that, while surveys by consulting firms and the Bureau of Labor Statistics indicate the number of flexible benefit plans is growing, they are not yet widespread in the private sector.

2) If the Subcommittee finds it desirable to adopt a flexible benefit plan for federal employees, GAO believes the flexible spending account approach would be the most practical design at this time. Flexible spending accounts allow employees to elect salary reductions to pay the employee's cost of specified benefits on a pre-tax basis. Employees could use these tax-free accounts to pay their share of the cost for existing health and life insurance programs. To extend the range of benefits to that covered by most private sector flexible spending accounts, a dependent care benefit could be added.

3) GAO estimates that if all federal employees use the spending accounts for salary reductions in the amounts that they now contribute toward the cost of their health and life insurance premiums, this approach would result in forgone tax revenues of $320 million to $600 million at 15 percent and 28 percent marginal tax rates. Adding a dependent care benefit would increase the tax loss. The tax laws now make this arrangement available to the private sector.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the potential design of a flexible benefit plan for federal employees. In recent years, employers have become more aware that with the prevalence of two-earner families and single parent households the benefits packages designed decades ago may be outdated. This realization has led to a movement toward flexible benefit plans which let employees have more say in selecting the types and level of benefits they receive.

We have not made an independent survey of private sector practices in this area. Thus, my remarks today are based on research of available literature and discussions with knowledgeable individuals in the benefits field. That research indicates that during its deliberations, the Subcommittee will need to consider three questions: (1) whether now is the time to adopt such a plan for federal employees, (2) what kind of plan would be best, and (3) what would be the resulting cost to the government.

IS NOW THE TIME?

To address the first question, we gathered available information on the prevalence of flexible benefit plans in the private sector. We did this because the government's compensation policy traditionally has been based on the principle of comparability with the private sector. This principle holds that the government should be neither ahead nor behind the nation's other employers in the compensation it provides its employees. Thus, we were interested in the extent to which such plans are available in the private sector.

We found that, while surveys by benefits consulting firms and the Bureau of Labor Statistics (BLS) indicate the number of flexible benefit plans is growing, they are not yet widespread in the private sector. A recent article pointed out that Hewitt Associates, a management consulting firm specializing in compensation, knew of only 8 companies with flexible benefit plans in 1980 but identified more than 600 firms which were expected to offer such plans by the end of 1987. A 1986 study by the Wyatt Company found that 11 percent of the 1418 firms it surveyed had flexible benefit plans. A 1986 BLS survey of over 1500 medium and large firms employing 21 million workers indicated that 5 percent of the employees were covered by some form of flexible benefit plan. Thus, while offering these plans is not the prevailing practice at this time, the number of employers offering such plans and the number of employees covered by them appears to be increasing.

WHICH DESIGN IS BEST?

Addressing the second question of what kind of flexible benefit plan would be best requires an understanding of the basic features of such plans. The literature indicates that these plans can encompass such benefits as medical care, accident and life insurance, dependent care, legal services, long term disability protection, and savings plan contributions. The option to receive extra vacation days or cash in lieu of benefits may also be available.

Plans allowing the greatest degree of flexibility, according to the literature, incorporate a core-plus-options design whereby the employer offers a basic core of benefits that is provided to all employees. Employees also receive optional credits that they can use to upgrade core benefits of their choice. Or, if they are satisfied with the core benefits, they might be allowed to receive the credits in the form of cash. Employers usually try to design their plans so that the cost of the core benefits plus the optional credits is the same as the cost of the previous benefits package.

Another key feature of most flexible benefit plans is a flexible spending account. Employees use these accounts to elect salary reductions to pay for the employee's cost of specified benefits. These salary reductions are tax free to the employee and do not add to the employee's cost of benefits. In some plans, flexible spending accounts constitute the only flexibility permitted by the employer; that is, these employers offer only core benefits with no optional credits. The flexibility that occurs in these instances is that the tax advantages employees receive from electing flexible spending accounts may allow them to increase their benefit coverage to a level they otherwise may not be able to afford.

Benefits most commonly funded through flexible spending accounts are medical and dependent care, although other benefits such as group term life insurance, disability benefits, and savings plan contributions may also be included. Retirement plans are generally not included. Employees determine the amount of the salary reduction to be set aside for each type of benefit. For example, an employee can elect a salary reduction amount to be set aside in an account for dependent care from which the employee will be reimbursed during the year as such expenses are incurred.

If the Subcommittee finds it desirable to adopt a flexible benefit plan for federal employees, we believe the flexible spending account approach would be the most practical design at this time. Our belief is based on the premise that this concept could be implemented without changing the existing benefits package and should thus be easier to understand by the employee and administer by the employer. For example, employees could use these accounts to pay their share of the costs for the existing health and life insurance programs.

Federal employees are already authorized to make savings plan contributions on a tax free-basis. Thus, to extend the range of benefits to that covered by most private sector flexible spending accounts, the Subcommittee may wish to consider adding a dependent care benefit. If authorized on an employee-funded basis, the dependent care benefit could be made available without increasing agency appropriations.

WHAT WOULD IT COST THE GOVERNMENT?

The Subcommittee will need to address the question of the cost to the government of adopting such a plan in view of the tax consequences associated with the flexible spending account approach. We estimate that if all federal employees choose salary reductions in the amounts that they now contribute toward the cost of their health and life insurance premiums, this approach would result in forgone tax revenues of $320 million to $600 million at 15 percent and 28 percent marginal tax rates. Adding a dependent care benefit would increase the tax loss.

The tax loss from adopting such a plan for federal employees would be considerable. But some points should be kept in mind when contemplating this amount. The tax laws permitting this concept have been in effect for several years. Precedent exists for federal employees to partake of similar tax-free benefits. The laws governing the new retirement system authorize employees to make savings plan contributions on a tax-free basis.

That concludes my prepared statement, Mr. Chairman. I would be pleased to answer any questions you may have.